

§ 1.996-5

26 CFR Ch. I (4-1-08 Edition)

(ii) The amount of any gain with respect to such redeemed stock which, under § 1.995-4, was treated as a dividend on a disposition prior to such redemption minus the amount of distributions with respect to such stock which have been treated as made out of previously taxed income by reason of the application of paragraph (a)(1) of this section.

(2) The provisions of this paragraph may be illustrated by the following examples:

Example 1. The entire stock of a DISC, which uses the calendar year as its taxable year, has been owned equally by A, B, C, and D since it was organized. At the close of 1976, when the DISC has \$100 of accumulated DISC income, it redeems all of A's shares in a transaction qualifying as an exchange under section 302(a) and A, under § 1.995-4, includes \$25 in his gross income as a dividend. The redemption has the effect of reducing accumulated DISC income by \$25 to \$75.

Example 2. Assume the same facts as in example 1 except that the stock of the DISC has not been held equally by A, B, C, and D since its organization. A purchased his shares from X in 1974 in a transaction in which X, under § 1.995-4, included in his gross income \$30 as a dividend. In 1975, A receives a distribution of \$10 out of accumulated DISC income which, under paragraph (a)(1) of this section, is treated as made out of previously taxed income. Under these facts, the redemption of A's stock in 1976 has the effect of reducing accumulated DISC income by \$45 to \$55 determined as follows:

(a) Accumulated DISC income	\$100
(b) Minus sum of:	
(1) Dividend on redemption of A's stock	\$25
(2) Excess of dividend on X's sale (\$30) over distribution to A treated as made out of previously taxed income (\$10)	\$20
Total	45
(c) Accumulated DISC income on 12/31/76	55

[T.D. 7324, 39 FR 35121, Sept. 30, 1974]

§ 1.996-5 Adjustment to basis.

(a) *Addition to basis.* Under section 996(e)(1) amounts representing deemed distributions as provided in section 995(b) shall increase the basis of the stock with respect to which the distribution is made.

(b) *Reductions of basis.* Under section 996(e)(2), the portion of an actual distribution treated as made out of previously taxed income shall reduce the basis of the stock with respect to

which it is made and, to the extent that it exceeds the adjusted basis of such stock, shall be treated as gain from the sale or exchange of property. In the case of stock includible in the gross estate of a decedent for which an election is made under section 2032 (relating to alternate valuation), this paragraph shall not apply to any distribution made after the date of the decedent's death and before the alternate valuation date provided by section 2032. See section 1014(d) for a special rule for determining the basis of stock in a DISC, or former DISC, acquired from a decedent.

[T.D. 7324, 39 FR 35124, Sept. 30, 1974]

§ 1.996-6 Effectively connected income.

In the case of a shareholder who is a nonresident alien individual or a foreign corporation, trust, or estate, amounts taxable as dividends by reason of the application of § 1.995-4 (relating to gain on disposition of stock in a DISC), amounts treated under § 1.996-1 as distributed out of accumulated DISC income, and amounts deemed distributed under § 1.995-2(a) (1) through (4) shall be treated as gains and distributions which are effectively connected with the conduct of a trade or business conducted through a permanent establishment of such shareholder within the United States, and shall be subject to tax in accordance with the provisions of section 871(b) and the regulations thereunder in the case of nonresident alien individuals, trusts, or estates, or section 882 and the regulations thereunder in the case of foreign corporations. In no case, however shall other income of such shareholder be taxable as effectively connected with the conduct of a trade or business through a permanent establishment in the United States solely because of the application of this section.

[T.D. 7324, 39 FR 35124, Sept. 30, 1974]

§ 1.996-7 Carryover of DISC tax attributes.

(a) *In general.* Carryover of a DISC's divisions of earnings and profits to acquiring corporations in nontaxable transactions shall be subject to rules generally applicable to other corporate tax attributes. For example, a DISC